

HIGHLIGHTS

ECONOMIC CONDITION AND OUTLOOK

The U.S. economy boomed in the final years of the 1990s, driven by a soaring stock market and strong productivity growth. However, in early 2000 the stock market bubble began to deflate and the economy started to slow. It quickly became clear that businesses had over-invested, which led to a sharp drop in investment spending. With the stock market no longer pushing household wealth upward, consumer spending also slowed. In March 2001 the record 10-year expansion of the 1990s came to an end, and the recession began. The weakened economy was struck another blow by the terrorist attacks of September 11.

The national recession has proven to be a mild one. Aggressive interest rate cuts by the Federal Reserve cushioned the recession's impacts by supporting the housing market, reducing the costs of borrowing, and keeping debt service burdens under control. Also helping to soften the downturn were federal tax cuts and tax rebates, federal spending increases for security and defense, and declining energy prices. In addition, although consumer spending slowed, it did not turn negative as is typical during a recession.

With its specialization in high tech business and flourishing dotcom sector, the Puget Sound region was a major player in the late 1990s boom. Venture capital flowed into the region, startup firms proliferated, and stock options turned many local workers into millionaires. However, when the tech boom faltered and the stock market bubble began to deflate, the region's growth trajectory turned down sharply. As their stock prices fell and sources of capital dried up, many of the region's dotcom firms failed while others laid off workers.

The September 11 attacks further slowed the region's economy and damaged businesses that are dependent on travel and tourism. Air travel dropped sharply, and the world's airlines began losing large amounts of money. This led Boeing to sharply reduce its production targets for airliners, which in turn reduced its need for workers. Currently, Boeing is in the process of eliminating approximately 20,000 local jobs by mid-2002.

As of April 2002 most economists agree that the national recession has ended and the recovery is now underway. Even the manufacturing sector, which suffered 18 months of contraction, is expanding.

The strength of the recovery will be restrained by high levels of personal and corporate debt, which limit the ability of consumers to spend and corporations to invest, and by rising energy prices. In addition, because consumer spending did not decline during 2001 as is typical during a recession, there is little pent-up consumer demand to drive a strong rebound in consumption.

Unlike the national economy, the region's economy is not yet showing signs of recovery, though there are some indications that it may have hit bottom. The region is lagging the nation in recovery largely because the local recession has been much more severe than the national recession, and the fact that Boeing will continue reducing employment through mid-2002. In addition, most of the local dotcom jobs that have disappeared are unlikely to return when the economy recovers.

Puget Sound region employment is forecast to be flat during 2002 following 2001's sharp decline. Employment growth is likely to resume during the first quarter 2003, but total employment is not expected to return to its fourth quarter 2000 peak until the third quarter 2004. In 2003 and 2004 the region's economy is expected to expand at a moderate pace, similar to that experienced in 1994-95. Growth will likely be much more restrained than it was during the late 1990s.

MAJOR INITIATIVES

Rebalancing the 2001 and 2002 Budgets

The recession that began in 2001 sharply reduced revenues available for the 2001 and 2002 General Subfund budgets. In response, the City imposed a hiring freeze beginning in September and took actions to reduce expenditures in the remainder of the year. This combination was successful in ensuring that the 2001 General Subfund budget remained in balance.

The 2002 Endorsed General Subfund budget required approximately \$24 million in changes in order to bring it back into balance as of November 2001. About \$16 million of this shortfall was related to economic conditions and the remaining \$8 million was due to the passage of Initiative 747 at the November 2001 General Election. This Statewide initiative lowered the maximum annual increase in property tax revenue for State and local governments to 1 percent annually, plus the value of new construction, versus the prior limit of 6 percent annually plus new construction. Since the 2002 Endorsed Budget had assumed a 6 percent increase, the net effect was a loss of \$8 million in property tax revenue for 2002, although this was ultimately reduced by using \$2.8 million of “banked” (previously authorized but not used) property tax capacity.

The 2002 General Subfund budget was rebalanced by making approximately 4 percent cuts in the appropriations of most departments receiving General Subfund support, recognizing delays in opening of certain new facilities, eliminating some new initiatives in the 2002 budget, recognizing debt service savings, and using fund balances in some operating funds. The City Council passed the revised budget in November 2001.

Model B&O Tax Ordinance

A group of Washington cities, including Seattle, completed development of a model Business and Occupation (B&O) tax ordinance in the fall of 2001. This ordinance is intended to standardize administration of local B&O taxes and to prevent multiple taxation of the same revenue by different jurisdictions. Seattle adopted the model ordinance in December.

West Coast Power Crisis

The combination of dry winter weather in 2000-2001, electricity shortages in California, and apparent market manipulation by large energy firms led to dramatic increases in the price of electricity in late 2000 and early 2001. Seattle City Light’s hydroelectric system did not produce enough power to meet its full needs due to the drought and thus was forced to purchase power at far higher than normal prices during this period. Rates were increased by about 60 percent in 2001 to cover some of the costs, but a substantial amount of borrowing was still necessary. The Utility issued \$182.2 million in two-year Revenue Anticipation Notes (RANs) in March 2001 to provide financing for the high power costs. City Light also made reductions in its capital and operating budgets.

To reduce the risk of this situation recurring in the future, City Light acquired additional energy from the Klamath Cogeneration Plant and the Stateline Wind Project. With these resources, the utility expects to have surplus energy in all but extremely dry years.

By the end of 2001 City Light was generating positive net operating revenues each month. This will continue until the RANs and interfund debt are repaid. The Mayor and Council adopted new financial policies for City Light, which will include the establishment of a cash reserve and more conservative forecasting approaches. The combination of these effects means that current rates are likely to remain in place through part of 2004, after which rates will decline to longer-term levels.

Major City Projects

Several major City construction projects continued in 2001, including the development of the downtown Civic Center. The Justice Center, which will house Police headquarters and the Municipal Court, remained on schedule for completion in October 2002. Ground was broken for the new City Hall, which is scheduled to open in the spring of 2003.

At Seattle Center the development of the new Fisher Pavilion began and the Opera House was closed to begin the redevelopment of this building into the Marion Oliver McCaw Performance Hall. The Performance Hall project will create a seismically sound, state-of-the-art venue for opera, ballet, and community performances. The Hall is being developed through a combination of public and private funds.

Development and remodeling of new libraries as a result of the 1998 Libraries for All bond measure continued in 2001. The existing Downtown Library was demolished and construction of the new building began. Several branch library sites were purchased and construction started on several facilities that will open in 2002 or early 2003.

The site for the Southwest Police Precinct was acquired and construction started in the fall. This facility will open in the first quarter of 2003.

Nisqually Earthquake

The Puget Sound area suffered a major earthquake on February 28, 2001. The so-called Nisqually quake caused substantial property damage throughout the region but miraculously caused no deaths or serious injuries. The City of Seattle had several facilities that received significant damage, including the Park 90/5 buildings being redeveloped for the Police Department, the Parks Department's Green Lake Shell House, the East Police Precinct, and various roadways. The City is working with the Federal Emergency Management Administration and its property insurer to recover most of the costs of repairs. Most minor repair projects were completed in 2001, and others are scheduled for 2002. The City also provided technical assistance to damaged private property, notably in the Pioneer Square neighborhood.

Water Treatment Facilities

Seattle Public Utilities provides retail water service in Seattle and neighboring areas and also serves as the wholesale provider of water for much of King County. The two principal water sources are reservoirs on the Cedar and Tolt rivers. In 2001 a new 120-million-gallon-per-day filtration plant was opened on the Tolt, which increases supply and improves water quality and appearance. This project was developed using an innovative design-build-operate (DBO) contract, which produced significant savings in capital and operating costs. Design for a treatment plant on the Cedar River was started in 2001 using a similar DBO approach.

Galer Flyover

The Seattle Transportation Department completed construction of the Galer Street Flyover, a new ramp providing improved traffic access to industrial property at the north end of Elliott Bay. Economic analyses have shown that the tax revenues resulting from new development allowed by the flyover will more than offset the costs for developing the structure. This project was completed several months ahead of schedule.

GOVERNMENTAL FUND-TYPE FINANCIAL INFORMATION

Governmental Fund-Type Revenues

The City's general governmental revenues fall into the following seven general classifications:

Taxes

Property, retail sales, utility, general business and occupation, and other local taxes.

Licenses and Permits

Occupational licenses, trade licenses, building permits, and other regulatory fees.

Grants, Shared Revenues, and Contributions

Federal, state, interlocal, and private grants and entitlements; state-shared revenues; payments in lieu of taxes; payments from other governments for services provided by the City; and private contributions.

Charges for Services

Admission charges and recreational program fees, charges for inspection, utility cuts, and other services. This category includes billings between funds of the City for services.

Fines and Forfeits

Primarily Municipal Court fines, bail forfeitures, and court costs. Ninety percent of the fines and bail forfeitures are distributed to the General Fund and the remaining ten percent to the Park and Recreation Fund.

Parking Fees and Space Rent

Revenues from parking, concession proceeds, and rents.

Miscellaneous Revenues

Interest earnings, program income, and other miscellaneous revenues.

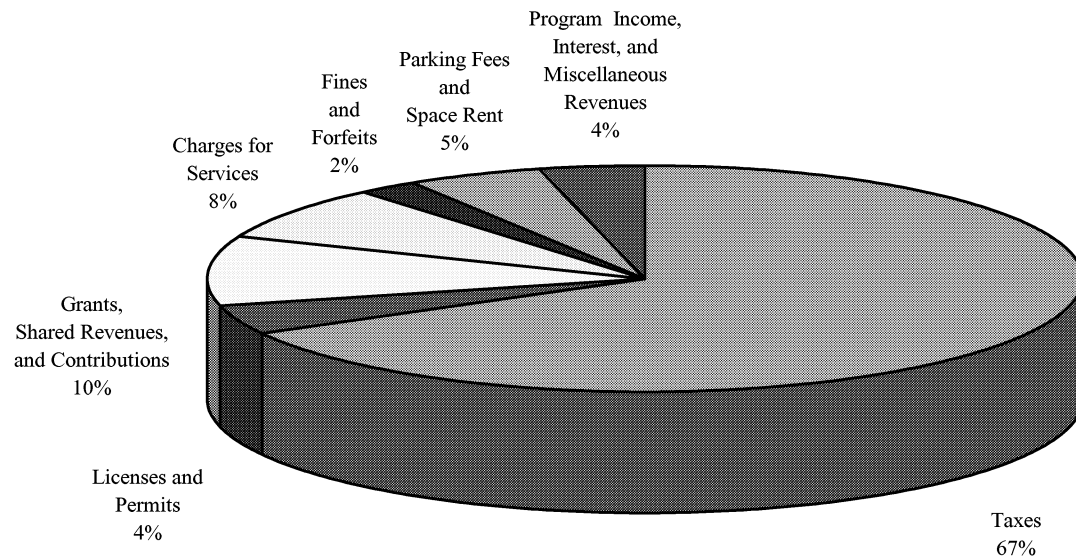
Shown below is a comparison of sources of revenues for 2001 and 2000 for the City's General, Special Revenue, and Debt Service Funds combined. This is followed by an analysis of the differences between years.

Table H-1 Revenue Summary

General, Special Revenue, and Debt Service Funds Revenues (In Millions)

Function	2001	2000	Increase (Decrease)	
			Amount	Percent
Taxes	\$ 610.2	\$ 597.4	\$ 12.8	2.1 %
Licenses and Permits	38.4	38.6	(0.2)	(0.5)
Grants, Shared Revenues, and Contributions	89.2	74.4	14.8	19.9
Charges for Services	74.0	74.3	(0.3)	(0.4)
Fines and Forfeits	18.4	18.5	(0.1)	(0.5)
Parking Fees and Space Rent	51.1	57.8	(6.7)	(11.6)
Program Income, Interest, and Miscellaneous Revenues	34.9	36.3	(1.4)	(3.9)
TOTALS	\$ 916.2	\$ 897.3	\$ 18.9	2.1 %

General, Special Revenue, and Debt Service Funds Revenues



Total \$916.2 Million

SIGNIFICANT REVENUE CHANGES BY SOURCE

Total tax revenues increased by \$12.8 million in 2001 to \$610.2 million. The largest increase was in property taxes, which were up 3.6 percent from \$194.8 million in 2000 to \$201.9 million in 2001. Since 1973, State law has limited the annual growth of the City's property tax revenue to 6%. There is one important exception to the annual growth limit related to new construction. Beginning in 1998 the pace of construction activity in Seattle has picked up each year adding significantly to the property tax base. New construction revenue for 2001 was over \$3.7 million. In November 2001 voters statewide approved Initiative 747, which changed the 106% limit to the lesser of 101% or the Implicit Price Deflator, effective for the 2002 collection year.

The Business and Occupation (B&O) tax is levied by the City on the gross receipts of most business activity occurring in Seattle. General B&O tax revenues grew at a healthy pace during the second half of the 1990s but revenue growth slowed abruptly in 2001. General B&O taxes remained relatively constant at \$122.4 million in 2001.

The City also levies a B&O tax on the gross income derived from sales of utility services by privately owned utilities within Seattle. These services include telephone, steam, cable communications, natural gas and refuse collection for businesses. These tax revenues increased in 2001, up \$3.3 million from \$54.5 million to \$57.8 million. The increase is attributed primarily to telephone utility tax revenues, which were up \$3.3 million, and natural gas and steam revenues that were up \$3.2 million. For the past several years wireless usage has achieved double-digit growth resulting in double-digit tax revenue growth from this industry. Energy costs were a hot issue in the Western United States in 2001. Volatile electricity prices drove up the demand and wholesale price for natural gas and consequently the rates for natural gas and steam customers. The B&O increases for privately owned utilities were offset by a shift in taxes from refuse collection for businesses. In 2001 under a new agreement with the State of Washington the City now has the responsibility to collect solid waste from commercial business locations. The City levies a B&O tax on most revenue collected by City-owned utilities (electric, water, drainage, wastewater, and solid waste). Rates for all public utilities except solid waste increased in 2001. As a result, and with the shift in the collection of refuse from commercial businesses, City-owned utility B&O revenues increased in 2001 by \$9.2 million.

Sales tax revenue declined in 2001 compared to 2000. A sharp slowdown in revenue growth began in the final months of 2000. The trend continued through 2001 and was exacerbated by the September 11 terrorist attack. Total revenues were \$132.4 million in 2001 compared to \$135.9 million in 2000. Revenues fell in all sectors except services, construction and finance, insurance, and real estate. The biggest drop was in wholesale trade, which reflects the sharp drop in investment spending that has characterized the recession.

At \$20.6 million, revenues from real estate excise taxes in 2001 were \$3.6 million lower than 2000. Although down in 2001, sales in both residential housing and the downtown commercial markets in Seattle have been exceptionally strong since 1998. The tax is levied when real estate is sold. The City receives 0.5 percent of the sales price on all commercial and residential sales.

The City imposes a tax on admission charges to most Seattle entertainment events. The tax is 5 percent of these charges, the maximum allowed by State statute. This revenue source is highly sensitive to unanticipated swings in attendance at professional athletic events as well as current economic conditions. At \$7.7 million, admission tax revenue remained relatively constant in 2001. In November 2000 the City Council passed an ordinance that dedicated 20 percent of the City's admission tax revenue derived from non-professional sports events to programs supported by the Seattle Arts Commission.

Licenses and Permits

The City requires that individuals and companies conducting business in Seattle obtain a City business license. In addition, some business activities require additional licenses that are referred to as professional and occupational licenses. The City also assesses fees for public safety purposes. With no change in permit charges, revenue from the majority of these sources was relatively stable in 2001. A large portion of the revenue from these fees is associated with construction activity. While revenue from private developers fell in 2001 due to the slowing economy, interfund transfers from City departments and revenues from other public agencies increased due to some very large projects by public entities. Overall, the City realized a decrease in revenues of \$0.2 million in 2001, a 0.5 percent decline from 2000 revenues.

Grants and Shared Revenues

These revenues include federal, state, interlocal, and private grants and entitlements, and state-shared revenues. Revenues from these sources increased from \$74.4 million in 2000 to \$89.2 million in 2001, a 19.9 percent increase. Federal direct grant revenues were up \$9.5 million to \$24.4 million. The City received reimbursement for expenses associated with the November 1999 World Trade Organization Conference. The City also began receiving FEMA grant funds for damages sustained in the February 28, 2001, earthquake. At \$18.3 million, federal indirect grants were up \$0.7 million compared to 2000. Revenues from State and local grants remained relatively constant at \$8.3 million and \$1.8 million respectively.

The State of Washington distributes a portion of various taxes directly to cities. Due to the passage of Initiative 695, the motor vehicle excise tax was eliminated effective in 2000. However, during the 2000 legislative session the State Legislature committed General Fund revenues to compensate local governments for the loss of the tax. In 2000 the City received \$1.6 million from the State and another \$3.1 million in 2001. Motor vehicle fuel taxes were up in 2001 by \$3.0 million after seeing a decline in 2000 of \$1.9 million. Vehicle license tax revenues were up by \$0.64 million to \$5.4 million while liquor tax revenues were down by \$0.3 million to \$4.9 million. Criminal justice revenues from the State's General Fund remained relatively constant at \$2.2 million.

Charges for Services

The City charges a variety of fees for services provided to City-managed utilities, other governmental entities, and the general public. In 2001 the City received approximately \$74.0 million from these fees, \$0.3 million less than in 2000. In March 2001 the Council authorized the Fire Department to establish and collect fees for emergency medical services provided by the department for special events. \$0.27 million was collected in 2001. Several Police revenues changed in 2001. Revenue from King County for the Automated Fingerprint System (AFIS) increased \$0.2 million while revenue from ID sales and a contract with the Washington State Criminal Justice Training Center decreased by approximately the same amount. Police fees for special events such as the making of films and commercials or traffic services provided for sports events, were up \$0.5 million to \$1.9 million in 2001. The Parks Department realized an increase in exhibit admission revenue of \$1.3 million due to increased fees for zoo admissions as well as increased attendance at the zoo. Parks recreational activity fees increased by \$2.6 million as a result of the new Interbay Golf Course. These were offset by a reduction of \$0.5 million in Parks revenue due to less work by the Seattle Conservation Corps. Various Transportation Department fees declined by \$3.3 million in 2001 as a result of less demand for services due to the economic downturn. Interfund service costs were up \$0.3 million after seeing a decline of \$1.0 million in 2000.

Fines and Forfeits

These revenues include fines and bail forfeitures levied by the City's Municipal Court, reimbursements for City litigation, and moneys forfeited during criminal proceedings. For 2001 the City received \$18.4 million from this category, about \$0.1 million less than the amount received in 2000. Historically, about 70 percent of these revenues are from parking fines, while much of the remaining comes from traffic violations. In 2001, revenue from traffic violations was down by approximately 10 percent but was offset by a corresponding increase in revenue from litigation recoveries.

Parking Fees and Space Rent

After several years of steady increases, the City realized a decrease in revenue in this category in both 2000 and 2001. Revenues were down from a 1999 high of \$59.2 million to \$57.8 million in 2000, to \$51.1 million in 2001. Parking and space rent revenues at Key Tower were down \$2.7 million. Key Tower, a major downtown building, was purchased by the City in 1996 to replace obsolete City office facilities. City staff are gradually moving into the building. In 2000 due to a market slow down, vacancies were up. The City took this as an opportunity to ready the space for some City staff earlier than originally planned. Parking and space rent revenues at Park 90/5 also declined in 2001. The City acquired Park 90/5 in 1996 for use as a new police support facility and for other City purposes. The City continues to collect rent from current tenants. Parking and space rent revenues were down \$1.9 million at the Seattle Center due to the temporary closure of some major facilities for redevelopment as well as a reduction in revenue from "premium seating" at sports events. For many years space rent revenues collected by the Fleets and Facilities Department have been deposited into the General Bond Interest and Redemption Fund to cover debt service on various City buildings. With a decline in debt service requirements in 2001 less space rent revenue was deposited into this fund. In 2001 the City received parking revenues of \$0.8 million from the Pike Place Market PDA in connection with City lots that they manage. At \$3.3 million, concession revenues remained relatively constant compared to 2000.

Miscellaneous Revenues

Miscellaneous revenues decreased by 4.4 percent in 2001 to \$34.7 million from \$36.3 million. In 2000 the City sold transferable development rights available from the Benaroya Hall Music Center for \$4.1 million in revenue. Realized interest earnings increased in 2001 up 7.6 percent to \$12.1 million. An unrealized interest earnings adjustment pursuant to Governmental Accounting Standards Board (GASB) Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, resulted in a decrease in 2001 revenue compared to 2000. Interest earnings from contracts and notes decreased in 2001 to \$1.1 million. Program income in the Low-Income Housing Fund decreased by \$0.6 million in 2001 to \$2.7 million. Earnings in 2000 were high due to partial repayment of temporary bridge loans and the higher than average payoff of Homewise single-family loans due to refinancing influenced by favorable interest rates. Both Block Grant float loan revenue and other program income in the Housing and Community Development Revenue Sharing Fund were down in 2001 compared to 2000 by \$2.7 million and \$0.5 million, respectively. Block Grant float loans, secured by irrevocable letters of credit, finance private construction at low interest rates until the City needs the money for programmatic purposes. The 2001 decrease reflects a much lower level of lending in that year. In 2001 the City received several large insurance payments including \$0.4 million related to the February 28, 2001, earthquake damage; \$2.0 million

related to a major fire; and \$2.0 million towards the repair of the Pergola, a historic landmark that was damaged in a traffic accident.

Governmental Fund-Type Expenditures

The City's expenditures are classified along functional lines, such as public safety, and by object of expenditure, such as employee salaries. The following are the City's functional categories of expenditures:

General Government

This category includes a variety of administrative functions necessary to develop City policies, direct the work force, manage the City's financial resources, and deliver services to customers. The departments that lead in policy making and management functions for the City include the Executive, Legislative, Law, Finance, Personnel, and the Information Technology Departments. The Executive Department, led by the Mayor, consists of several offices including the Office of the Mayor, the Office of Economic Development, the Office of Intergovernmental Relations, the Office for Civil Rights, the Office of Sustainability and Environment, the Office of Housing, and the Strategic Planning Office. The Legislative Department consists of the Seattle City Council and the City Clerk's Office.

At year-end 2000 the Executive Services Department was reorganized into four new departments: the Departments of Finance, Personnel, Information Technology and the Fleets and Facilities Department.

Public Safety

Expenditures in this category cover law enforcement, community policing and crime prevention, the municipal criminal justice system, fire protection and prevention, emergency medical services, hazardous materials control, and emergency management.

The Police and Fire Departments, the Seattle Municipal Court, and the Criminal Division of the Law Department provide public safety services. The City also supports police and fire fighter pension systems and the Public Safety Civil Service Commission, which administers the civil service system for uniformed police officers and fire fighters. The City contracts with King County for jail and public defense services to Municipal Court defendants. Other City programs provide assistance to crime victims, diversion of offenders from jail to mental health and drug and alcohol abuse treatment, funding of community crime prevention councils, and support services to criminally involved youth.

Physical Environment

This category includes services provided to achieve a satisfactory living environment for the community and individuals. The City reports spending for such activities as pollution control under this category.

Transportation

Transportation expenditures include the costs to maintain, repair, and upgrade the City's bridge and street systems; install and maintain traffic control signals, signs, and markings; and administer rideshare and related alternative transportation programs. The Seattle Transportation Department is responsible for administering these services.

In November 2000 Seattle voters approved Initiative 53 establishing an Elevated Transportation Company (ETC) to prepare a Seattle Popular Transit Plan (SPTP) for a monorail system. Pursuant to Initiative 53, the City is providing funding to the ETC.

Housing and Human Services

Prior to 1999 the Department of Housing and Human Services was responsible for administering most of the services in this category. In 1999 the Department was renamed the Department of Human Services and the housing functions were transferred to a new Office of Housing. Community agencies provide the City's human services, youth development, childcare, Head Start, healthcare, elderly care, food banks, and shelters in neighborhoods throughout the City. The City provides support and resources to the agencies and directs their efforts toward the highest priority services. The City's federally funded Community Development Block Grant and locally funded Human Services Program combine to provide housing; health care; economic development; emergency shelter; feeding programs; food banks; services to the elderly, children, and youth; and other vital services to low-income residents of Seattle.

The Office of Housing administers the local housing levy, the low-income weatherization and residential rehabilitation and the federal HUD HOME grant programs. The City's low-income housing programs provide local, state, and

federal funds for private and public developers to acquire, rehabilitate, weatherize, and maintain low-income housing units and single-family homes.

Planning and Development

Expenditures for Planning and Development are used to protect and enhance the physical environment. The Department of Design, Construction, and Land Use (DCLU) develops codes which reflect City land use and development policies. DCLU also has responsibility for the review and permitting of development applications, inspection of new construction, and enforcement of the codes for land use and for housing and building maintenance. The purpose of the Department of Neighborhoods (DON) is to help preserve and enhance Seattle's diverse neighborhoods, to empower people to contribute to their communities, and to bring government closer to all people, ensuring governmental responsiveness. Beginning in 1999 all functions, responsibilities, and assets of the Neighborhood Planning Office were transferred to DON. With this change, DON greatly expanded its role to include coordinating the implementation of 37 neighborhood plans developed by the Neighborhood Planning Office. The Planning Commission advises the Mayor, City Council, and City departments on broad planning goals, policies, and plans for the physical development of the City.

Health

This category includes expenditures to promote the general health and well-being of City residents with an increasing focus on health promotion and disease prevention for the population at large. The Seattle-King County Department of Public Health administers the program. The Department of Public Health is a joint venture of Seattle and King County providing personal and environmental health services throughout the County. Health services for Seattle residents are provided primarily through the Community-Oriented Primary Care Division, the Division of Alcoholism and Substance Abuse, the Prevention Division, the North Region and the Central Region of the Seattle-King County Health Department. Seattle appropriates funds to pay King County for services provided to Seattle residents.

Culture and Recreation

Culture and recreation expenditures provide City residents with opportunities and facilities for cultural, recreational, and educational programs. These costs relate primarily to programs of the Arts Commission, Seattle Center, Seattle Public Library, and the Parks and Recreation Department.

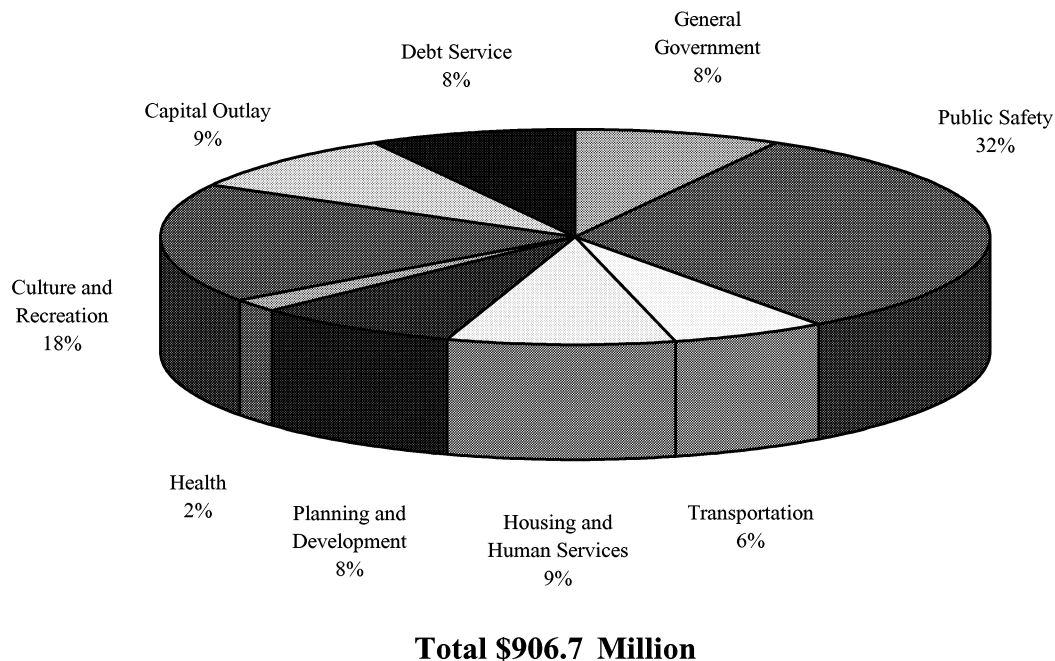
The following summary of the City's general, special revenue, and debt service funds compares the functional expenditures of these funds. This is followed by an analysis of the differences between years.

Table H-2 Expenditure Summary

General, Special Revenue, and Debt Service Funds Expenditures (In Millions)

Function	2001	2000	Increase (Decrease)	
			Amount	Percent
Current				
General Government	\$ 67.2	\$ 46.5	\$ 20.7	44.5 %
Public Safety	293.1	277.2	15.9	5.7
Physical Environment	2.0	0.4	1.6	400.0
Transportation	57.6	61.9	(4.3)	(6.9)
Housing and Human Services	83.7	77.6	6.1	7.9
Planning and Development	71.5	63.2	8.3	13.1
Health	16.7	16.1	0.6	3.7
Culture and Recreation	165.1	153.7	11.4	7.4
Capital Outlay	78.0	52.1	25.9	49.7
Debt Service	71.8	69.4	2.4	3.5
TOTALS	\$ 906.7	\$ 818.1	\$ 88.6	10.8 %

General, Special Revenue, and Debt Service Funds Expenditures



SIGNIFICANT EXPENDITURE CHANGES BY FUNCTION

General Government

General government expenditures increased by \$20.7 million to \$67.2 million, 44.5 percent higher than 2000 spending. Four items accounted for the bulk of the change. Expenditures were significantly higher in 2001 due to the settlement of several major claims against the City. In addition to the settlement costs, due to the heavy caseload, the Law Department also used the services of outside attorneys to handle some of the cases. Health care costs were up significantly in 2001. The City became partially self-insured in 2000 and distributes the cost of health care to the various City departments based on a rate established as a part of the budget process. The assumptions used to develop the 2001 rates underestimated Citywide claims costs. Utilization was higher than expected, as were catastrophic claims and third-party administrative costs. Prescription drug costs, technological advances, and an aging work force have all contributed to double-digit health care inflation. Industrial Insurance claims exceeded 2001 projections by 20 percent. Claims experience has been highly volatile and difficult to project. Lastly, the cost of operating the Key Tower building was up in 2001. Property management and operating costs as well as costs for building access and security improvements increased.

Public Safety

The cost for public safety rose \$15.9 million, a 5.7 percent increase over 2000 spending. The Nisqually earthquake on February 28, 2001 required a series of immediate responses from departments such as police and fire that resulted in increased costs. Both departments also increased service levels following the September 11 act of terrorism. Additionally, the Fire Department sent an Urban Search and Rescue team to New York to assist in the recovery effort. Circumstances requiring the staffing of special events, combined with City policy to fully meet authorized levels of uniformed officers in the Police Department through an accelerated hiring and training program, also resulted in costs that were higher than 2000. Jail service costs rose 15.6 percent in 2001 to \$12.6 million. The City pays a daily inmate fee to King County for housing inmates. King County's booking and daily maintenance charges both increased in 2001 as did the average length of stay.

Physical Environment

This category of expenditures increased from \$0.4 million in 2000 to \$2.0 million in 2001. As part of a Citywide response to the listing of Chinook salmon as a threatened species, the City is working towards reductions in reliance on pesticides and herbicides. The City has also pledged to curb air pollution through a joint effort with the Puget Sound Clear Air Agency, eight other Puget Sound area governments, and companies doing business in the region.

Transportation

Transportation operating expenditures decreased by \$4.3 million in 2001, down 6.9 percent to \$57.6 million. The decline in spending is attributed to the declining economy and reduced demand for reimbursable work. However, in this same period transportation capital expenditures increased by \$21.0 million to \$40.8 million. The department spent in excess of \$8.0 million in repairs due to the 2001 earthquake. Several large projects such as the West Galer Flyover, also went into the construction phase during 2001. General Fund support to the Seattle Transportation Department has more than quadrupled since 1995. Commute trip reduction is also a high priority for the City, with the goals of reducing traffic congestion and related environmental impacts. In 2001 the City contributed \$1.6 million pursuant to Initiative 53 passed by the voters in 2000. Initiative 53 requires the City to provide \$6.0 million towards a monorail planning effort.

Housing and Human Services

In 2001 the City increased its spending in this category by \$6.1 million from \$77.6 million to \$83.7 million. Spending in the Low-Income Housing Fund increased \$5.8 million. This fund is used to preserve, rehabilitate, or replace low-income housing as well as to provide home repair and assistance to home buyers. The increased spending is attributed to the cyclical nature of housing projects. Most housing projects are multiyear in duration from acquisition to final dispersals, which contributes to this cyclical nature. Spending was also up in the Human Services Operating Fund, increasing by \$6.1 million to \$42.2 million. Besides inflationary increases, spending increased in a variety of programs such as youth services, homeless and, domestic violence. These increases were offset by decline in the Housing and Community Development Revenue Sharing Fund where expenditures were down in 2001 by \$5.5 million due to the reduction in float loan activity. The Office of Housing also realized expenditure reductions of \$0.6 million in 2001 due to a change in the size and scope of jobs associated with the weatherization program.

Planning and Development

Expenditures in this category increased \$8.3 million, up 13.1 percent to \$71.5 million. Spending in the Department of Design, Construction, and Land Use (DCLU) led the way, up 18.4 percent to \$36.5 million. Record-setting levels of permitting activity prompted DCLU to add permanent positions and employ temporary personnel and consultants. The largest percentage of the increase was related to construction activity. Other large expenditures were due to spending on process improvements and technology. Strategic Planning Office (SPO) spending increased in excess of \$0.6 million in both the General Fund and in the Education and Development Services Fund. Office of Economic Development spending also increased by about \$0.6 million. The increased costs are associated with various studies and projects such as Sound Transit, South Lake Union, and EDA's Small Business Assistance.

Health

Payment to the County for Seattle's share of health care costs was relatively constant compared to 2000. Public health expenditures increased by \$0.6 million, a 3.7 percent increase to \$16.7 million.

Culture and Recreation

This category of expenditures increased by \$11.4 million to \$165.1 million in 2001, a 7.4 percent increase. The largest increase occurred in the Park and Recreation Fund where costs rose \$10.0 million in 2001, 11.7 percent higher than 2000 spending. As well as inflation, the increased costs covered additional parks maintenance and programs funded by the new Pro Parks Levy. The Parks Department incurred expenditures of \$2.2 million relating to the new Interbay Golf Course as well as \$0.5 million on the new Zoo African Gateway Village and the South Lake Union Armory. Costs at the Library increased \$1.5 million in 2001, a 4.2 percent increase to \$37.6 million. At \$27.6 million, costs at Seattle Center remained constant in 2001 compared to 2000.

Capital Outlay

With the exception of transportation capital spending, most City construction is recorded in capital projects funds and is not included on this table. Capital outlay expenditures in the governmental funds increased in 2001, up \$25.9 million from \$52.1 million to \$78.0 million. The largest increase occurred in the Transportation category, up \$21.0 million. Capital outlay spending in the Culture and Recreation category was up by approximately \$4.0 million. The significant increase in Transportation capital spending was due to the move of projects from the less costly design phase into the construction phase as well as the street repair costs associated with the 2001 earthquake. In the culture and recreation category, many of the costs were associated with renovation and repair of buildings as well as parks improvements and property acquisitions.

Debt Service

Debt service spending increased from \$69.4 million in 2000 to \$71.8 million in 2001. The City issued \$129.7 million in Limited Tax General Obligation Bonds in 2001. No general obligation bonds were issued in 2000.

Table H-3 General Fund

Expenditures and Encumbrances by Object (In Millions)

	2001	
	Amount	Percent
Personal Services	\$ 294.7	62.8 %
Other Services and Charges	149.5	31.9
Capital Outlay	25.1	5.3
Debt Service	-	-
TOTAL	\$ 469.3	100.0 %

The expenditures of the City's General Fund are also classified by object as shown above. The City's major investment is in its people, as shown by the percentage of the General Fund expended on salaries and benefits. In addition, a significant percentage of payments made to other funds for services (interfund expenditures) are used to pay salaries and benefits of employees providing those services.

General Fund Consolidation

The General Fund includes fourteen other subfunds: Arts Account, Cable Television Franchise, City Hall, Police Support Facility, Cumulative Reserve, Emergency, Judgment/Claims, Neighborhood Matching, Development Rights, Special Employment Program, Industrial Insurance, Unemployment Compensation, Health Care, and Group Term Life Insurance. The following table provides a summary of the status of the various subfunds at year end 2001.

Table H-4 General Fund Subfunds (In Thousands)

	General	Arts Account	Cable Television Franchise	City Hall	Police Support Facility
Revenues					
Taxes	\$ 521,375	\$ 958	\$ -	\$ -	\$ -
Licenses and Permits	10,644	-	2,081	-	-
Grants, Shared Revenues, and Contributions	18,635	-	-	-	-
Charges for Services	12,400	-	-	-	-
Fines and Forfeits	16,166	-	-	-	-
Parking Fees and Space Rent	10,355	-	-	17,128	1,580
Program Income, Interest, and Miscellaneous Revenues	6,213	16	795	200	-
Total Revenues	595,788	974	2,876	17,328	1,580
Expenditures	367,310	756	-	10,410	775
Other Financing Sources and Uses					
Sales of Fixed Assets	127	-	-	-	-
Operating Transfers In	3,354	-	-	716	716
Operating Transfers Out	(237,910)	-	(2,581)	(10,038)	(1,034)
Total Other Financing Sources and Uses	(234,429)	-	(2,581)	(9,322)	(318)
Fund Balances					
Fund Balance Reserves	15,909	180	-	88	2,261
Designated for Subfund Purposes	-	39	1,465	10,411	-
Undesignated and Unreserved	637	-	-	-	-
Total Fund Balances	16,546	219	1,465	10,499	2,261

	Cumulative Reserve	Emergency	Judgment/ Claims	Neighborhood Matching	Development Rights
Revenues					
Taxes	\$ 20,649	\$ -	\$ -	\$ -	\$ -
Licenses and Permits	-	-	-	-	-
Grants, Shared Revenues, and Contributions	670	562	-	-	-
Charges for Services	641	-	-	-	-
Fines and Forfeits	-	-	-	-	-
Parking Fees and Space Rent	839	-	-	-	-
Program Income, Interest, and Miscellaneous Revenues	3,223	2,052	2,185	-	180
Total Revenues	26,022	2,614	2,185	-	180
Expenditures	23,456	5,158	14,097	3,568	-
Other Financing Sources and Uses					
Sales of Fixed Assets	18,757	-	-	-	-
Operating Transfers In	1,616	7,000	15,935	4,428	-
Operating Transfers Out	(9,403)	(8,578)	-	(407)	(4,315)
Total Other Financing Sources and Uses	10,970	(1,578)	15,935	4,021	(4,315)
Fund Balances					
Fund Balance Reserves	50,029	9,494	5,252	5,440	-
Designated for Subfund Purposes	13,717	8,594	-	339	26
Undesignated and Unreserved	-	-	-	-	-
Total Fund Balances	63,746	18,088	5,252	5,779	26

	Special Employment Program	Industrial Insurance	Unemployment Compensation	Health Care	Group Term Life Insurance	Total General Fund
Revenues						
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 542,982
Licenses and Permits	-	-	-	-	-	12,725
Grants, Shared Revenues, and Contributions	-	-	-	-	-	19,867
Charges for Services	738	-	-	-	-	13,779
Fines and Forfeits	-	-	-	-	-	16,166
Parking Fees and Space Rent	-	-	-	-	-	29,902
Program Income, Interest, and Miscellaneous Revenues	-	521	-	4,870	275	20,530
Total Revenues	738	521	-	4,870	275	655,951
Expenditures	695	1,983	498	9,946	3	438,655
Other Financing Sources and Uses						
Sales of Fixed Assets	-	392	-	-	-	19,276
Operating Transfers In	-	-	-	853	-	34,618
Operating Transfers Out	-	-	-	-	(853)	(275,119)
Total Other Financing Sources and Uses	-	392	-	853	(853)	(221,225)
Fund Balances						
Fund Balance Reserves	-	240	-	4,681	-	93,574
Designated for Subfund Purposes	2,078	3,239	853	-	2,642	43,403
Undesignated and Unreserved	-	-	-	-	-	637
Total Fund Balances	2,078	3,479	853	4,681	2,642	137,614

UTILITY FINANCIAL INFORMATION

Net loss for the City's four utilities totaled \$70,089 million for 2001. The following table presents the four utilities' net income or loss for the last ten years. A brief discussion of major financial events in each utility follows.

Table H-5 Utility Net Income (Loss) (In Thousands)

	Seattle Public Utilities			
	City Light	Water	Drainage and Wastewater	Solid Waste
1992	\$ (14,063)	\$ 1,078	\$ (2,998)	\$ (8,594)
1993	(10,170)	4,409	(1,273)	(8,530)
1994	270	2,842	1,144	(6,320)
1995	(4,102)	918	2,176	(1,952)
1996	23,013	1,324	2,249	(1,335)
1997	26,429	(2,446)	4,229	378
1998	(22,576)	390	2,012	716
1999	7,738	(3,412)	(22)	903
2000	(35,785)	25,911	971	2,417
2001	(73,341)	4,884	(2,198)	566

City Light

Summary of Financial Results

City Light's financial results in 2001 were severely impacted by poor water conditions in the Northwest region and high prices in the wholesale electricity market in the Western United States. Due to low rainfall and streamflows in the watersheds supplying the Department's hydroelectric resources, the Department was required to purchase large amounts of energy in the wholesale market through September 2001 in order to serve its retail customers. Prices in the wholesale market through May 2001 were at extraordinarily high levels throughout the Western region. The Department's need to purchase wholesale energy diminished in the second half of the year, as contracts for the purchase of additional power from the Klamath Falls Cogeneration Project and the Bonneville Power Administration took effect. City Light had surplus power available for sale in the fourth quarter, but by that time wholesale market prices had fallen and the Department was unable to realize the expected benefits of its surplus position. The Department raised rates four times in 2001 to deal with the financial effects of its high power costs. However, the additional revenue from these rate increases offset only a portion of the increase in power costs. The Department therefore experienced a net loss of \$73.3 million for the year after deferral of \$300 million in excess power costs from 2001 to future years.

Operating Revenues

Retail Power Revenues

Revenue from sales of energy to retail customers in the Seattle service area totaled \$503.4 million in 2001, an increase of 28.6 percent over the \$391.6 million in revenue recorded in 2000. This increase occurred in spite of the fact that the quantity of energy delivered to retail customers actually declined by 5.9 percent from the 2000 level. Consumption of electricity in the service area declined in response to rate increases and the Department's campaign for reduction of energy use. Rates were increased four times in 2001. Average rates increased by 9.8 percent on January 1, 18.0 percent on March 1, 9.3 percent on July 1, and 10.3 percent on October 1. The first three increases were required in order to offset the effect of high purchased power costs. The final increase passed through to customers the financial effects of increases in Bonneville power rates on October 1, 2001, as mandated by the City Council.

Wholesale Power Sales

Wholesale power revenues include revenue from short-term sales to utilities and other wholesale market participants, the valuation of power delivered under seasonal exchanges, and other energy credits. Revenue from sales of energy in the wholesale market fell from \$103.1 million in 2000 to \$75.3 million in 2001, a decrease of 26.9 percent. The quantity of energy sold was 78.9 percent lower in 2001 than in the preceding year. The decrease in energy sold was offset by an increase in the average sales price, from \$46.04 per MWh in 2000 to \$161.90 in 2001. The value of energy delivered to other utilities under seasonal exchange contracts and other energy credits totaled \$33.2 million in 2001, a substantial increase from the \$5.1 million recorded in 2000. This increase was in part due to a change in the method of calculating the value of energy delivered under exchange contracts.

Transmission and Other Revenues.

Transmission and other revenues include revenue from basis sales, from the rental of utility properties, from the sale of transmission rights, and from miscellaneous fees and charges. Revenue in this category increased from \$5.9 million in 2000 to \$15.6 million in 2001. Basis sales involve the simultaneous purchase and sale of power at different geographical points with a result that is equivalent to the transmission of power from the point of purchase to the point of delivery. Valuation of the delivery side of basis transactions in 2001 amounted to \$6.9 million, an increase of \$6.4 million over the 2000 level. Rental of transmission lines to the Bonneville Power Administration (BPA) generated \$1.3 million in 2001, an increase of \$0.6 million from 2000. Revenue from the sale of transmission rights provided an additional \$1.5 million in 2001, or \$0.6 million more than in 2000. Miscellaneous fees and charges brought in \$5.9 million in revenue in 2001, compared with \$3.8 million in 2000.

In summary, total operating revenue increased from \$505.6 million in 2000 to \$627.6 in 2001. By far the largest part of this increase was a result of rate increases enacted in 2001.

Operating Expenses

Operating Expenses increased from \$543.7 million in 2000 to \$654.8 million in 2001, an increase of \$111.1 million, or 20.4 percent. Increases in costs related to long-term purchased power contracts account for three-quarters of the increase. Significant increases also occurred in short-term wholesale power purchases, transmission expenses, customer service costs, and taxes. A decline in generation costs partially offset the growth in these categories.

Long-Term Purchased Power

The cost of power purchased under long-term contracts with other utilities increased from \$79.3 million in 2000 to \$151.2 million in 2001, an increase of \$71.9 million, or 90.7 percent. On July 29, 2001, the Department began to receive power from the Klamath Falls Cogeneration Project under the terms of a contract that took effect on July 1, 2001. Power delivered from this project cost \$18.4 million in 2001. Purchases of power from BPA under a new contract effective October 1, 2001, increased significantly from 195 average MW under the former contract to 502 average MW in the fourth quarter of 2001. The rates charged by Bonneville for this power under the new contract were also higher because Bonneville had exercised its right to increase rates to cover the increase in its costs resulting from poor water conditions and high wholesale prices. As a result, the cost of power purchased from BPA increased from \$34.4 million in 2000 to \$66.8 million in 2001. The value of energy delivered to City Light under seasonal exchanges increased from \$6.4 million in 2000 to \$28.0 million in 2001, largely as a result of a change in the method of valuing the energy received. The cost of power purchased under other long-term contracts fell slightly, from \$38.5 million in 2000 to \$38.0 million in 2001.

Wholesale Power Purchases: Short-Term

Poor water conditions in 2001 required City Light to purchase large amounts of energy in the wholesale market at elevated prices. City Light incurred costs of \$520.4 million in purchased power in the wholesale market in 2001, an increase of \$308.4 over the 2000 level of \$212.0 million. The average price paid for the 2,411,210 MWh of power purchased in 2001 was \$215.15 per MWh. In 2000 City Light paid an average of \$86.47 for 2,451,348 MWh of wholesale power. In addition, the Department paid \$4.0 million to large industrial customers for voluntary curtailment of consumption during the period of high market prices in 2001, compared to \$0.4 million in 2000.

In May 2001 the City Council authorized the Department to defer a portion of the cost of wholesale power purchases in 2001 and to amortize the deferred costs in future years. Accordingly, excess power costs in the amount of \$300 million have been deferred from 2001 to future years. Because of the deferral, only \$224.4 million of wholesale power costs are shown as an expense in 2001.

Transmission

Transmission expense grew from \$21.7 million in 2000 to \$30.3 million in 2001, an increase of \$8.5 million, or 39.3 percent. The valuation of the purchase side of basis transactions accounts for \$4.4 million of this increase. The cost of transmission services under contracts with BPA increased by \$3.1 million from 2000 to 2001. The Department contracted for an additional 650 MW of transmission capacity from BPA, effective October 1, 2001, to accommodate the higher amount of power available under the new power sales contract with BPA. In addition, BPA's transmission rates increased by 24.3 percent on October 1, 2001.

Customer Service

The cost of customer services rose from \$22.2 million in 2000 to \$27.5 million in 2001, an increase of \$5.3 million. Bad debt expense increased by \$1.9 million, reflecting the economic slowdown in the Puget Sound region and the increases in City Light's rates in 2001. The implementation of the City's new Consolidated Customer Service System

for City utilities accounted for an additional increase of \$1.4 million from the 2000 level. Expense for media advertising, primarily to encourage curtailment of consumption during the period of high wholesale market prices in 2001, increased by \$1.3 million over 2000. Other customer service expenses grew by \$0.7 million.

Generation

Operating and maintenance expenses for the Department's generating resources decreased from \$25.7 million in 2000 to \$17.0 million in 2001, a decrease of \$8.7 million. The sale of the Department's 8 percent share of the Centralia Steam Plant in May 2000 accounts for \$7.1 million of the decrease. Hydroelectric operations and maintenance expenses declined by \$1.6 million from 2000 to 2001, due in part to a credit for prior-year administrative charges paid to the Federal Energy Regulatory Commission and to lower operating costs at the South Fork Tolt Project.

Taxes

Tax expense was \$52.6 million in 2001, an increase of \$9.7 million from the 2000 level. Taxes paid to the City of Seattle and the State of Washington account for most of the growth in this category. State and City taxes are levied as a percentage of gross revenue. The increase in tax payments parallels the increase in revenue.

Other Operating and Maintenance Expenses

Increases in the value of the Department's plant and equipment, including the new customer billing system, resulted in an increase of \$6.0 million in depreciation expense, from \$55.5 million in 2000 to \$61.5 million in 2001. Distribution expenses increased from \$34.5 million in 2000 to \$36.5 million in 2001. Administrative and general expenses, net of amounts allocated to capital projects, rose from \$37.0 million to \$39.1 million. Both of these increases reflect a reduction in the level of activity in the Capital Improvement Program, which resulted in a corresponding shift of costs to operating activities and a lower allocation of administrative and general expenses to capital projects. Conservation costs increased from \$7.0 million to \$8.5 million, reflecting an increase in the amortization of past conservation investments. Power marketing and system control expenses increased from \$5.5 million in 2000 to \$6.1 million in 2001.

Non-operating Revenues (Expenses)

Interest Expense and Amortization of Debt Expense

Debt-related expenses, including interest and the amortization of debt expense, increased from \$53.2 million in 2000 to \$73.9 million in 2001, reflecting interest expensed on bonds and notes issued in 2000 and 2001. In December 2000 the Department issued \$98.8 million in long-term bonds to finance capital requirements. In March 2001 the Department issued an additional \$503.7 million in long-term bonds to finance capital expenditures and refinance certain outstanding bonds. In the following month \$182.2 million in two-year bond anticipation notes were issued to fund the anticipated deficit in the Department's operating cash flow. Interest costs on these issues were partially offset by the effect of the March 2001 refunding of \$125.1 million in outstanding bonds. Also, \$9.8 million in interest costs on the March 2001 long-term bond issue was paid from bond proceeds rather than from current revenues.

Investment Income

Investment income of \$13.5 million in 2001 exceeded the 2000 level of \$9.8 million by \$3.7 million. The increase is attributable to interest earnings on the investment of the unused proceeds of the March 2001 first-lien bond issue, partially offset by interest on borrowing from the City's cash pool. As of December 31, 2001, \$161.7 million of bond proceeds remained in the Construction Account. At various points in 2001 the Department's cash balance in the City's cash pool was negative. Interest expense related to the Department's negative balances offset interest earnings on the Construction Fund and the Bond Reserve Account. In December 2001 the City Council authorized a loan of \$110.0 million from the cash pool to cover the negative balances. As of December 31, 2001, the outstanding balance on the loan from the cash pool was \$100.0 million.

Gain on Sale of Centralia Steam Plant

In 2000 the Department recorded a gain of \$29.6 million from the sale of its 8 percent share of the Centralia Steam Plant. There was no comparable transaction in 2001.

Fees, Grants, and Transfers

As required by GASB Statement No. 33, in 2001 the Department began reporting non-exchange transactions as revenues on the operating statement. Fees, grants, and transfers in 2001 amounted to \$15.3 million. Capital fees, previously reported in equity, as contributions in aid of construction, constitute the main component of this category. In 2001, capital fees, mainly

in the form of construction charges, were \$12.5 million. Operating grants from the state and federal governments, primarily to support conservation and renewable investments, and a transfer from the City of Seattle to fund conservation programs and support for low-income customers totaled \$2.8 million.

Net Income (Loss)

The Department recorded a net loss of \$73.3 million in 2001 versus a net loss of \$52.0 million in 2000. Retained earnings as of December 31, 2001, were \$300.1 million.

Seattle Public Utilities (SPU)

WATER FUND

Financial Performance

As an issuer of long-term revenue bonds, the Water Fund pledges to maintain revenues sufficient to cover 125 percent of its parity debt. To be able to manage revenue fluctuations caused by seasonal weather patterns and to be able to maintain a satisfactory bond rating, the Water Fund plans for financial performance well above its pledge to bond holders. Specifically, the Water Fund plans to achieve positive net income, positive year-end operating cash, and debt service coverage of 1.70. In addition, to limit the growth in outstanding debt, the Water Fund plans to fund no more than 80 to 85 percent of its Capital Improvement Program (CIP) from long-term debt.

In 2001 the Water Fund met its cash and net income targets but not its targets for debt service coverage and CIP financing. The Water Fund ended the year with \$1.2 million in operating cash and \$4.9 million in net income. The debt service coverage ratio for 2001 was 1.37. Of the \$78.8 million dollars spent on the CIP, 90.2 percent was financed with long-term debt.

Revenues

Total operating revenues of \$105.3 million were generated in 2001, \$103.8 million of which were from metered water sales. Metered water sales were \$0.4 million lower than in the previous year because of poor water sales resulting from voluntary water curtailment and a cool wet summer.

Expenses

At \$86.3 million, total operating expenses in 2001 were \$13.0 million or 17.8 percent higher than in 2000. An earthquake in February of 2001, the settlement of damage claims, high customer service call volumes and the operation of the new Tolt water filtration plant all contributed \$7.7 million of this increase. The remaining \$5.3 million was from increases in depreciation and amortization costs.

Capital Improvement Program (CIP): Expenditures and Financing

Expenditures on the Water Fund's CIP totaled \$78.7 million in 2001. Twenty-four percent of these expenditures were for water quality projects including \$9.8 million for a treatment plant on the Cedar River supply. Another twenty-four percent of CIP expenditures were for water supply and conservation programs including \$11 million for a second pipeline from the Tolt River source and \$3.3 million for conservation programs. Thirty-six percent of CIP expenditures were for infrastructure improvements including \$2.5 million in watermain replacements.

The CIP was financed primarily from debt with 9.8 percent of the funding coming from a combination of operating revenues and contributions from developers, customers, other utilities, and transportation agencies. To finance the debt-related portion, the Water Fund exhausted the proceeds of bonds issued in 1999 and sold an additional \$52.5 million in long-term revenue bonds in November 2001.

Water Supply

The water supply outlook in early 2001 was well below average. In order to ensure that water supplies would be sufficient, in the spring customers were asked to voluntarily reduce their water use. Voluntary curtailment and cool wet August weather reduced annual demand by 7 percent compared to a normal year. Snowpack in 2002 is above average, and the water supply outlook for 2002 is good.

Regional Water Governance

The Seattle water system provides retail water service to an area slightly larger than the corporate boundaries of Seattle, and it provides wholesale water service to 26 water districts and municipalities in King County. The water system provides direct service to a population of about 597,000 people and indirect service to a population of almost 691,000 people. In all, most of the developed portion of King County is served by the Seattle system. Sales to the water district and municipalities are governed by 30-year contracts signed in 1982 and new 60-year contracts signed in 2001.

Six wholesale customers have signed new water supply contracts. The hallmark of these new contracts is an Operating Board that participates in the management of the regional water supply and transmission system. Seattle continues to negotiate new contracts with the remaining 20 wholesale customers.

Watershed

The City's two forested watersheds in the Cascade Mountains are closed to development and unsupervised human activity. Land development impacts and more stringent regulatory standards have made ownership of the watersheds an increasingly important element of the City's overall strategy to preserve and enhance water quality. The City increased its ownership of its Tolt River watershed to 70 percent through a land exchange completed in 1997. Since 1996 the City has owned 100 percent of the 141-square mile Cedar River Watershed. The City holds non-operating properties throughout the State of Washington originally acquired for the Cedar land exchange, which it intends to sell.

To provide greater long-term certainty for its water supply operations and minimize the possibility of future protracted litigation, the City has negotiated the terms of a Habitat Conservation Plan (HCP) with the U.S. Fish and Wildlife Service, National Marine Fisheries Service, the Corps of Engineers, Washington State Departments of Fisheries and Wildlife and Ecology. An Agreement-In-Principle for the HCP was signed by the parties in March 1997 settling interrelated issues involving fishery mitigation, watershed restoration, and instream flow requirements. The HCP was approved by the parties in early 2000.

Water Quality

The City's long tradition of aggressive action to protect the watersheds for the Cedar and Tolt sources and to maintain water quality has ensured a supply noted for its high quality. To meet disinfection requirements of the U.S. Environmental Protection Agency (EPA) and State Department of Health (DOH) for public water systems, SPU currently disinfects its water with chlorine. SPU also fluoridates the water and adds minerals to decrease its corrosivity.

To provide additional public health benefits and to increase the reliability and yield of its Tolt source, SPU has added a filtration plant on its Tolt River supply. The 120 MGD (millions of gallons per day) facility is financed and owned by the City but was developed and operated by a private contractor through an innovative design-build-operate process. Construction of the \$100 million facility was completed in late 2000.

Under a DOH directive, the City completed a study of treatment options for the Cedar including ozone and filtration. Following the study, the City proposed and DOH and EPA approved a recommendation to construct an ozonation facility with the capacity to add filtration facilities if necessary or appropriate. In 1997 SPU began the EIS work for the construction of the ozonation plant. The City is proposing to complete this facility through a design-build-operate agreement similar in form to the one used for the Tolt Filtration Plant. The Cedar treatment facility is expected to be in service in 2004.

The City has also prepared a long-term plan to cover all nine of its open distribution reservoirs. This plan was approved by DOH in January 1996. Design work on the first three reservoirs began in 1997. Construction of the first reservoir cover was completed in 2001, and a second reservoir cover will be completed in 2002.

New Technology

The City's financial system was replaced in 1999 and SPU's Billing System was replaced in 2001. Near-term future technology improvements include a new Supervisory Control and Data Acquisition (SCADA) system for automated monitoring and operation of the water system and an automation of certain water quality lab operations.

DRAINAGE AND WASTEWATER FUND

The Drainage and Wastewater Fund (DWF) finances the management of sanitary sewer and storm drainage systems to safeguard public health, property, and water quality. DWF revenues include wastewater volume charges, surface water management (drainage) fees, permit and connection charges, interest income, and grant revenues.

The Drainage and Wastewater Fund sets financial targets of positive net income, debt service coverage of 1.5, and an operating cash balance of \$6.7 million for 2001. The Fund met its target for debt service coverage with a 2001 ratio of 2.6:1. In 2001 DWF experienced a net loss of \$2.2 million as compared to a gain of \$1 million in 2000. The Fund's operating cash balance was \$10.9 million, well exceeding the financial policy target of \$6.7 million.

Sewer revenue in 2001 was \$113.4 million as compared to \$114.4 million in 2000. A rate increase of 3.9 percent in 2001 was offset completely by reduced water use resulting from voluntary drought-management water curtailment efforts. Drainage rate revenues increased from \$16.1 million in 2000 to \$22.8 million in 2001 primarily because of a 2001 rate increase.

Wastewater Collection, Treatment and Disposal

The City contracts with King County for the treatment and disposal of wastewater. This contract expires on July 31, 2036. In 2001 DWF paid \$80.4 million to King County for wastewater treatment, compared to a prior year total of \$78.3 million.

In May 1997 the County issued the Draft Regional Wastewater Services Plan (RWSP) which proposed four alternatives for meeting the region's wastewater treatment needs through the year 2030. The plan was adopted by the County Council in December 1999 with a net present value cost of \$1.2 billion. Implementation of the plan began in 2000 with conveyance and storage projects and initial siting work for a northend treatment plant.

The City is responsible for collecting and transporting sewage to the King County system and is responsible for 80 Combined Sewer Overflow (CSO) locations. A combined sewer carries both sanitary sewage and stormwater runoff. During peak storms, runoff volumes are greater than the pipe system can handle, causing diluted sewage to overflow into surrounding bodies of water. The Fund financed a total of \$16 million in sewer-related capital improvement projects during 2001, including \$4.2 million for the South Lake Union CSO project. The Lake Union CSO project is designed to control City overflows into Lake Union, while other past CSO projects have controlled overflows into Lake Washington, Portage Bay, and the Duwamish River.

The Fund also spent \$0.5 million on its new sewer program and \$6 million on sewer pipe and pump station repair and replacement during 2001. SPU uses closed circuit television inspection and an automated maintenance management system to identify parts of the system in need of renovation or replacement. Pipes are repaired through insituform technology, causing minimal disruption to the street surface.

Stormwater Management

SPU is the lead agency responsible for surface water management in the City of Seattle, with funding provided by DWF. The Fund spent \$15 million on drainage-related capital projects in 2001, including \$1.3 million to replace a failing culvert at 35th Avenue NE and NE 125th Street, \$1 million on improvements to Longfellow Creek, and \$0.8 million on the design of detention ponds to be constructed in 2002 and 2003 at the Jackson Park Golf Course. Surface water runoff can be a major problem in urban areas because so much of a city's land is covered by buildings or pavement, and downstream systems lack capacity to carry the flow. By constructing stormwater detention and conveyance systems in the City, SPU continues to make significant progress in solving these problems.

In 1987, amendments to the Federal Clean Water Act established new statutory requirements to control industrial and municipal discharges to waters of the United States. Municipalities such as Seattle, with separate storm sewer systems serving populations of 100,000 or greater, were required to obtain a National Pollutant Discharge Elimination System (NPDES) permit for their stormwater discharges. The City submitted its Notice of Intent requesting such coverage under an NPDES permit, and coverage was granted by Ecology in 1995 under the stormwater general permit for the Cedar/Green Water Quality Management Area. This permit contained a requirement for the City to submit a Stormwater Management Program (SWMP), a program designed to reduce the discharge of pollutants and minimize impacts of stormwater runoff on receiving water bodies. The SWMP describes the City's regulatory, public education, water quality, maintenance, monitoring, capital improvement, and toxic control programs. Seattle's SWMP was approved by Ecology in 1997. Although the current NPDES Stormwater permit expired in July 2000, the City retains coverage for its stormwater discharges under the NPDES program until a new permit is issued. Ecology anticipates issuing the next stormwater permit in 2002. The renewed permit is likely to include more prescriptive requirements for construction of stormwater treatment facilities and water quality monitoring Citywide.

SOLID WASTE FUND

The financial targets for the Solid Waste Fund in 2001 were debt service coverage of 1.5, positive net income, and positive cash balances. The Fund, which generated debt service coverage of 3.96, earned \$0.56 million in net income, and ended the year with \$0.5 million in operating cash, met or exceeded all of its financial targets. To meet its cash target, however, the Solid Waste Fund required a short-term \$3.0 million loan from the City's Cumulative Reserve Subfund. This loan was necessary because of initial challenges related to the new commercial contracts. (See below.)

2001 Solid Waste Fund operating revenue was \$104.4 million, about 22 percent higher than in 2000. Operating expenses in 2001 (\$103.6 million) were also about 20 percent higher than in 2000. Both the increased revenues and expenses were primarily the result of the City's new commercial contracts.

Rates

The City's residential solid waste customers pay for solid waste services based on the size of the garbage can they choose. Charges increase with the size of the can, encouraging customers to recycle and minimize the amount of waste they produce. The City implemented an average rate increase of 2.8 percent on December 31, 1999. It also implemented several changes to the Recycling and Disposal Station rates on January 1, 1999. These were the first rate increases since September 1994. As of April 1, 2001, the City assumed control of commercial garbage rates. 2001 commercial rates were based on Washington Utilities and Transportation Commission rates.

Collection

The City contracts with private companies for the collection of residential garbage, yard waste, and recycling. New residential contracts were implemented in April 2000. For several years the City had been in negotiations with the State-franchised haulers that collected commercial waste in the City to bring them under contract with the City. These negotiations were successful, and as of April 1, 2001, commercial garbage was collected under these new contracts.

Disposal

Under an agreement signed with Washington Waste Systems (WWS) in 1990, the City began shipping its residential and commercial garbage to WWS's Columbia Ridge landfill in Arlington, Oregon, in April 1991. The first full year of operation under this long-haul disposal system was 1992. In conjunction with the new commercial collection contracts, the first opt-out date of the disposal contract was pushed out from March 2006 to March 2009 in exchange for price reductions of \$1.50/ton in 2003, an additional \$1.50/ton in 2005, and a final \$1.50/ton in 2007.

SPU has completed the process started in 1984 of closing its two landfills: Midway and Kent Highlands. The Midway closure project was completed in 1992 and Kent Highlands was completed in 1995. The final net cost of the two projects is estimated at about \$69.9 million. Solid waste rates continue to include the debt service on outstanding long-term insured debt issued in 1989 to cover these closure projects. (These bonds were refunded in 1999 for a net present value savings of \$2.9 million.) In 1998 postclosure costs of \$31.4 million were recognized as a long-term liability and offset by a deferred asset. These postclosure costs are being amortized rather than being treated as cash operating expenses as they were prior to 1994.

Comprehensive Plan

State regulations require the City to produce a solid waste comprehensive plan every five years. The City's second required comprehensive plan was published in 1998 and outlines the City's solid waste management goals and strategies. Three key values underlie the Plan: protecting public and environmental health, improving cost-effectiveness and system efficiency, and responding to customer and community needs.

PENSION TRUST FUND OPERATIONS

The operation of the Seattle City Employees' Retirement System (SCERS) resulted in a net negative total return of 6.0 percent in 2001. The Plan Net Assets showed a decrease of \$109.4 million at the end of 2001. The total net assets held as of the end of 2001 is \$1.384 billion. As of January 2000 the actuarial valuation showed a \$179.6 million funding excess.

DEBT ADMINISTRATION

As of December 31, 2001, the City had the following debt outstanding: \$782.3 million of general obligation (GO) bonds; \$21.7 million in capital leases, other notes and contracts; \$104.5 million in other liabilities that are general obligations of the City; \$2.49 billion of revenue bonds and anticipation notes; and \$19.1 million in proprietary fund leases and notes. The City has also guaranteed the debt service on six special obligation bond issues, which have outstanding balances of \$59.9 million. The City would have to pay debt service on these bonds in the event revenues from the projects are insufficient to maintain the debt service reserve accounts at their required levels.

The City's unlimited tax general obligation bonds are rated Aaa by Moody's Investors Service, AAA by Fitch IBCA, and AAA+ by Standard & Poor's. The City's limited tax general obligation bonds are rated Aa-1 by Moody's, AA+ by Fitch, and AAA+ by Standard & Poor's.

Under State statute the City's general obligation debt was limited to 7.5 percent of assessed value. The 2002 assessed value for the City is \$75.5 billion. The debt covered by statute includes general bonded debt of \$784.3 million, which includes \$2.0 million in deferred interest on the 1998, Series E, GO bonds; \$0.1 million of capital leases; \$36.9 million for compensated absences; and \$59.9 million of special bond issues on which debt service is guaranteed by the City. The City's net general obligation debt is \$870.4 million as of December 31, 2001.

On March 12, 2001, Moody's Investors Service downgraded the rating on the City's fixed-rate Municipal Light and Power revenue bonds from Aa2 to Aa3. An explanation of the significance of and the reasons for such a downgrade may be obtained from Moody's Investor Service. On January 25, 2001, Standard & Poor's downgraded the rating on the City's fixed-rate Municipal Light and Power revenue bonds from AA to AA-. An explanation of the significance of and the reasons for such a downgrade may be obtained from Standard & Poor's. On October 26, 2001, Standard & Poor's downgraded the rating on the City's fixed-rate Municipal Light and Power revenue bonds from AA- to A. An explanation of the significance of and the reasons for such a downgrade may be obtained from Standard & Poor's. As of December 31, 2001, the long-term underlying ratings on the City's fixed-rate Water System revenue bonds were Aa2 from Moody's Investors Service and AA from Standard & Poor's. The long-term underlying ratings on the City's Drainage and Wastewater revenue bonds were Aa2 from Moody's Investor Service and AA- from Standard & Poor's. The long-term underlying ratings on the City's Solid Waste revenue refunding bonds were A1 from Moody's Investor Service and A+ from Standard & Poor's.

In 2001 the City issued \$129.8 million of new general obligation debt.

In 2001 the City issued \$503.7 million Municipal Light and Power Improvements and Refunding Revenue Bonds, \$182.2 million Municipal Light and Power Revenue Anticipation Notes, \$60.7 million Drainage and Wastewater Revenue Bonds, and \$52.5 million Water System Revenue Bonds.

CASH MANAGEMENT

The Treasury Services Division of the Department of Finance administers all cash-related transactions for the City of Seattle. City cash (exclusive of pension fund cash administered by the Seattle City Employees' Retirement System and some debt refinancing proceeds administered by trustees) is deposited into a single concentration banking account. Cash expenditures are paid from a consolidated disbursement account. Investments of temporarily idle cash are made according to City Council mandated policies in U.S. Treasury and agency issues, Bankers' Acceptances sold on the secondary market, Commercial Paper purchased in the secondary market, Repurchase and Reverse Repurchase transactions, and other securities as authorized by law. The City is allowed to engage in securities lending transactions, the fees for which are credited to the investment income account. City policies require the City to minimize market risks by safekeeping all purchased securities according to governmental standards for public institutions, to maintain liquidity by restricting the City's total investment portfolio to an average life of no more than five years, and to consider social goals in the placement of investments. A report on the performance of Treasury Services in meeting these policies is prepared monthly for review by the Director of Finance and the City Council.

The market value of investments held in the pooled and dedicated funds' combined portfolio under the direct supervision of Treasury Services as of December 31, 2001, was \$823.7 million, with earnings of \$42.8 million and a return on investment of 5.12 percent.

RISK MANAGEMENT

In 2001 the City purchased insurance policies to address general, professional, public official and other liabilities; excess workers compensation; all risk property coverage including earthquake and flood, with boiler and machinery, builders risk, and electronic data processing endorsements. Insurance was also purchased for fiduciary and crime liability, contractors' equipment, transportation, inland marine, fine arts, railroad protective liability, and an assortment of commercial general liability, medical, accidental death and dismemberment, and miscellaneous policies. Bonds were purchased for public officials, notary public, and pension exposures.